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May 6, 1997

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The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Bldg.
U.S. House of Representatives
Washington, DC 20515

Dear Representative Dingell:

Attached are my responses to the very thoughtful and important questions that you forwarded to me by letter dated April 10, 1997. Please note that while I am currently the President of the National Association of State Utility Consumer Advocates (NASUCA), the attached responses represent only my own views as the Consumer Advocate of Pennsylvania.

As you may know, Pennsylvania has moved to the forefront among states that have begun to implement retail electric generation competition. I have enclosed for your review a letter that I wrote to Governor Tom Ridge and the members of the Pennsylvania General Assembly stating why I supported the legislation that gave rise to customer choice for electric generation suppliers in Pennsylvania. I have also enclosed, however, an article that I wrote for the Washington Times of April 8, 1997, stating my opposition to federal legislation that would mandate retail electric competition throughout the Nation by a date certain.

In my view, it is not a coincidence that the states who have moved most quickly toward greater retail competition are states like Pennsylvania with high electricity rates that are due in large part to high cost nuclear power plants. It remains to be seen whether our efforts to bring rates down through competition in Pennsylvania will succeed, but I can certainly recognize the concerns of consumers in low cost states who may see little advantage and great potential harm by moving too quickly to a competitive model. Even worse from my perspective, some federal legislative proposals would actually undermine competitive efforts in high cost states, because the federal competition mandate would be coupled with the requirement that utilities must be fully compensated for all costs that are "stranded" due to retail competition. In my view it would be a cruel joke on the American people to mandate "competition" by a near term date certain, while at the same time ensuring that most consumers would see no benefit from such competition for a decade or more because of a federal mandate that ratepayers must make their utilities whole for every penny of uneconomic investments that they could not recover in a truly competitive market.

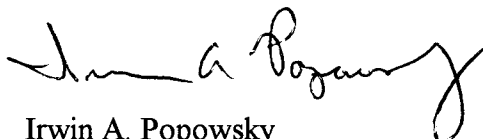
I do not advocate legislation either at the state or federal level that flatly prohibits any recovery of retail stranded costs. Rather, I think that each state commission must determine what the

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just and reasonable level of recovery should be in light of that state's historic allocation of utility generation risks and costs. It is absurd, however, for advocates of retail competition to promise substantial immediate rate cuts at the same time they are promising 100% recovery of and return on utility stranded costs.

I apologize that I have not had as much time as I would like to develop the answers to the following questions. We are in the midst of the restructuring cases that our electric utilities already have begun to file in Pennsylvania. Nevertheless, I would greatly appreciate the opportunity to discuss these issues further with you or Ms. Sheridan at any time of your convenience. Also, if I or other members of NASUCA can be of assistance to you as this debate continues, please do not hesitate to contact me or our NASUCA Executive Director Charles Acquard, at (202) 727-3908.

Sincerely,

A handwritten signature in black ink, appearing to read "Irwin A. Popowsky". The signature is fluid and cursive, with a large, stylized "P" at the end.

Irwin A. Popowsky
Consumer Advocate

cc: Sue Sheridan
Charles Acquard

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Questions and Responses
Re: Electric Industry

John D. Dingell, Ranking Member
Commerce Committee Democratic Office

1. How has the increased competition in wholesale electric markets affected consumers in your State to date?

Response: It is difficult to measure the effects of wholesale competition on retail consumers. Because reductions in wholesale energy costs generally have been flowed through to retail consumers through our Energy Cost Rates, I believe that consumers have benefitted somewhat. It should be noted though, that even if lower cost wholesale power is available to utilities, retail ratepayers continue to pay for their own utilities' high capital cost power plants in base rates. In other words, as long as the utility has a monopoly over its retail generation customers, it can continue to charge the full capital costs of its own power plants to ratepayers, even while the utility is purchasing lower cost power on the wholesale market.

2. What role has your office played in any state proceedings on retail competition? What position has your office taken on the issue of whether or not retail competition would benefit consumers and on the issue of whether or not federal legislation mandating adoption of retail competition by a date certain, or any other type of federal legislation, is needed? Do you believe there are substantial differences among the various states' consumer advocates, and why or why not?

Response: My Office has been extremely active in every aspect of the retail competition debate in Pennsylvania both in the legislature and before the Public Utility Commission. As set forth in my enclosed letter to Governor Ridge and the members of the Pennsylvania General Assembly, I believe that consumers in Pennsylvania can benefit from a reasonable transition to retail generation competition. Our rates in Pennsylvania are very high, due in large part to generation choices made by some of our utilities. As noted in my enclosed Washington Times article, however, I would oppose federal legislation that mandates retail competition nationwide by a date certain. I believe there are substantial differences among state consumer advocates on the relative costs and benefits of retail generation competition. Some advocates in high cost states such as Pennsylvania see retail competition as a way of reducing rates for generation that could only be imposed by a monopoly on

captive customers. Other advocates, particularly in lower cost states, see little benefit from an immediate transition to retail competition. They also have serious concerns about the impact of retail competition on residential and low income consumers as well as potential environmental concerns.

3. Some proponents of federal legislation mandating that states adopt retail competition by a date certain argue that substantial numbers of large industrial customers recently have negotiated favorable rates with their public utility commissions. Such proponents have further argued that residential and small commercial consumers lack bargaining power to achieve similar rate reductions. Finally, these proponents argue that federal legislation is essential to ensure that smaller consumers are not economically disadvantaged relative to large industrial customers.
 - a. Please indicate whether or not you agree with the three premises outlined above.
 - b. In particular, please indicate whether you have reason to believe that large industrial customers are being favored in rate negotiations before public utility commissions relative to smaller commercial and residential customers. What type of state statutory direction generally governs such rate determinations? Historically, how have states balanced the interests of different customer classes? Is this changing?
 - c. What position has your office taken in recent rate proceedings concerning large industrial customers' requests for rate reductions?
 - d. In general, have consumer electricity prices in your State been rising, holding steady, or falling, and why?

Response: I agree that industrial customers have long exercised the ability to force rate reductions because of their ability to threaten to shift production or actually move their plants to other states. New industrial customers can win rate concessions as part of a package of incentives offered to entice them to move into the state. In Pennsylvania, our commission recently estimated that 5601 industrial customers received more than \$445 million in rate breaks from Pennsylvania electric utilities between 1984 and 1995. I agree that residential and small business customers lack the same type of bargaining power, but I don't see that as an argument in favor of federal legislation. Rather, I see this as an aspect of the balancing of interests that each state must undertake as part of its decision regarding when and how to move to greater retail competition.

In my view, large industrial customers in recent years have been able to receive favorable treatment in rate proceedings and through special negotiations with utilities because of the substantial economic development impact that those customers have. Pennsylvania law does not specifically permit or prohibit these types of rates, as long as they are not "unduly discriminatory." Pennsylvania, in my view, has given increased deference to the economic development needs of large industrial customers in recent years.

My Office originally opposed several industrial discount rates on the ground that they would lead to higher rates for other consumers. We were wholly unsuccessful in trying to prevent these rates from going into effect, however, and have since focussed on trying to prevent utilities from shifting the costs of industrial discounts onto small consumers. Typically utilities have been required to “eat” the discounts between base rate cases, but then have been able to seek recovery of lost revenues from other customers prospectively in base rate cases.

In general, electric rates rose rapidly in the 1970's and 1980's, but have leveled in the 1990's after our utilities completed their large construction programs that produced many of the earlier rate increases.

4. What are the most difficult issues to resolve in connection with utilities' stranded costs? To the extent your State has adopted, or is consider adopting, retail competition, has there been an attempt to distinguish between costs which were prudently incurred and those which were not? If Congress were to enact legislation mandating that states adopt retail competition by a date certain, what, if any, provisions relating to stranded costs should be included? Is securitization a useful tool, and how would it affect different interests?

Response: In Pennsylvania, the Commission must determine what is a just and reasonable sharing of stranded costs. This requires a balancing of the interests and expectations of investors and consumers. The question is not whether the costs were prudently incurred. If the costs had been imprudent, they should not have been included in rates in the first place and therefore would not be stranded by competition. The question is whether ostensibly prudent investments that are rendered non-used and useful by competition should nevertheless continue to be charged in full to consumers. In states like Pennsylvania, it has long been held that utilities are not entitled to a full return on and recovery of non-used and useful investments (including uneconomic excess capacity), even if those costs were prudently incurred. In a case that I argued before the United States Supreme Court, Duquesne Light Company v. Barasch, the Court rejected the utilities' challenge to the Pennsylvania used and useful statute even though the application of that statute resulted in the total disallowance of over \$40 million of prudently incurred costs on four cancelled nuclear power plants. It is inconceivable to me that Congress could develop a single stranded cost rule that would fairly treat both utilities and ratepayers in all 50 states. These costs were incurred under specific regulatory regimes and a result that would be just and reasonable in Pennsylvania, given our historic allocation of risks and costs, might be wholly unfair to either utilities or ratepayers in another state. Under no circumstances should federal law attempt to address the treatment of retail stranded costs, other than perhaps to require that each state specifically address the issue.

Securitization can be a useful tool to lower the cost to ratepayers of stranded cost recovery, but only if there is first a determination that the costs involved will certainly be stranded, and second that it is just and reasonable to impose those costs on ratepayers. It must be recalled that securitization involves an irrevocable order which locks in stranded cost recovery for the life of the securitized bond. Because the interest rate on the securitized bond will likely be lower than the

utility's overall cost of capital, securitization can reduce the charges on stranded costs. But again, ratepayers only benefit if it is absolutely clear that these costs would have been recovered anyway at the higher capital cost.

5. Some proponents of retail competition hold the view that all electricity resources should be sold at market prices and that state authority to regulate retail rates should be eliminated. Could such a policy result in rate increases for customers that currently receive the benefit of such low-cost resources? In a restructured electric utility industry, who should receive the benefits of these low-cost resources--utility ratepayers, utility shareholders, or simply the highest bidder?

Response: I would agree that in the future, the market likely will do a better job than regulation in establishing the price of retail electric generation. (I would note that this answer only applies to electric generation, not distribution, which remains a natural monopoly that should continue to be regulated.) The question of how to allocate the benefits of low cost existing resources is the mirror image of the stranded cost issue on high cost resources. This is a transitional issue which, in my view, should be decided on a state by state basis.

A good example of how this issue should **not** be resolved is found in FERC Order 888. In my view, FERC's policy is designed to allow low cost producers to sell at market-based rates, while high-cost producers will charge the sum of market price plus stranded costs. Since market price plus stranded costs equals the current high embedded cost, that means that FERC policy is to allow utilities to sell at the higher of cost or market. This also means that consumers can never benefit from competition as long as stranded costs are being recovered. This is because customers of low cost utilities will pay the market price (even if that price is higher than the utility's actual cost), while customers of high cost utilities will pay market price plus stranded costs.

6. Recently there has been increased discussion of the need for Congress to enact "reciprocity" requirements barring retail sales of power by parties located in states which have not adopted retail competition to parties in states which have adopted retail competition.
 - a. Do you have a position on this issue?
 - b. Which interests would benefit from a federal reciprocity requirement, which would not, and why?

Response: The Pennsylvania statute did not impose a reciprocity requirement. In my view, such a requirement would have harmed Pennsylvania consumers by limiting customer choice. A federal reciprocity rule would protect utilities from competition from utilities in other states that did not yet allow retail competition, but I am not sure that such a requirement would benefit consumers in either state.

7. Does your State currently have adequate tools to protect the interests of low-income electricity consumers if Congress were to mandate retail competition by a date certain? If such legislation were enacted, do you have any recommendations as to how Congress should approach this important issue?

Response: The new Pennsylvania electric competition law specifically requires each utility to address low income concerns as part of its competitive restructuring plan. Our law also requires each utility to maintain low income utility programs at least at their pre-competition levels. Since I am opposed to a federal retail competition mandate, I do not think this issue needs to be addressed at the federal level. If there were a federal retail competition mandate, however, I would support a provision similar to that in Pennsylvania which would require utilities to specifically address low income issues as part of their restructuring plans.

8. Do you have any concerns about reliability of service or the ability of the interstate transmission or local distribution systems to handle the transactions that would occur if retail competition became more prevalent?

Response: I believe that reliability concerns can be addressed adequately from a technical standpoint. The more difficult question, I think, is how to reconcile the need for reliability with the need to keep the ownership and control of the transmission and distribution systems from being used as a means of thwarting generation competition. The efforts to establish an Independent System Operator in the Pennsylvania-New Jersey-Maryland (PJM) Interconnection have been fraught with problems to date. It is essential that these issues be resolved in a way that reliability is preserved but full and fair competition is permitted.

9. Are rural and urban consumers in different positions with respect to their relative ability to bargain for competitive electricity prices? Are all consumers similarly situated in terms of aggregation?

Response: In contrast to the telephone industry, where I think rural customers are in significant jeopardy, I believe rural and urban electricity customers are in relatively equal positions. That is because, in electricity, the competition is supposed to occur at the generation level. The distribution system will remain regulated. I see no reason that rural customers ought not to be able to have comparable access to competitive generation, as long as the distribution systems that serve them are not subject to competition. It may be easier to aggregate customers in concentrated urban areas, and thus reduce transaction costs per customer. But generally, the cost of providing electric generation service in rural areas ought not to be much different than in urban areas.

10. Some proponents of retail competition have argued in favor of federal legislation requiring states to adopt retail competition regimes which include mandatory unbundling of those

services currently provided by local distribution companies. What advantages and disadvantages might this pose for consumers? Do you have any recommendations?

Response: Unbundling is certainly necessary as part of any restructuring. At a minimum, generation service must be unbundled from other services, so that generation can be provided on a competitive basis. I have not yet determined whether further unbundling, for example, of metering and billing services, should be implemented at this time or whether it would be preferable to go forward at least initially with generation unbundling only. In any case, I still see no reason for a federal unbundling mandate. Each state that has addressed this issue has been able to make this determination without a federal mandate.

11. There is a wide divergence of opinion as to whether or not the Public Utility Holding Company Act of 1935 (PUHCA) should be modified or repealed. In view of the recent merger trend, PUHCA's protections have significance for all states, whether or not they traditionally have been served by a registered holding company.
 - a. Do you believe PUHCA is a significant impediment to competition, at the wholesale or retail level, or can "effective competition" be achieved regardless of whether Congress enacts changes to PUHCA?
 - b. Do you believe Congress should modify or repeal PUHCA, why, and under what, if any, conditions?
 - c. Should Congress enact legislation to modify the holding in Ohio Power v. FERC, 954 F.2d 779 (D.C. Cir. 1992)?

Response: The genius of PUHCA is that its structural protections created an electric industry structure that made it possible for states to regulate electric utilities in a manner that was consistent with the public interest. State regulation of "local" electric utilities has served the public interest well and ought not to be lightly discarded in the name of competitive "progress." As we are now seeing in the telecommunications industry, the promise of competition seems to be giving way to greater consolidation and there appears to be nothing that the application of traditional antitrust principles can do about it. It appears, under antitrust theory, that the merger of two adjacent giant monopolies doesn't actually reduce competition; it just creates a larger giant monopoly. I am not aware of any potential electric generation competitors in Pennsylvania who have indicated that they cannot participate in Pennsylvania's competitive market because of PUHCA. To the extent that PUHCA could prevent some potential competitors from leveraging their monopoly power in other states to succeed in Pennsylvania, then that is not the kind of competition that we should be concerned about missing. Particularly in light of the modifications that were made to PUHCA in 1992, I am not sure why it would be necessary to amend PUHCA at this time. To the extent Congress wishes to address PUHCA at all at this time, it should be to overturn the perverse precedent created by the Ohio Power decision.